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UNCLAS SECTION 01 OF 02 REYKJAVIK 000219

USDOC FOR LEAH MARKOWITZ
TREASURY FOR LAWRENCE NORTON
STOCKHOLM FOR FCS

SIPDIS

SENSITIVE

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SUBJECT: ICELANDIC GOVT TAKES CONTROL OF BANKING SECTOR AMID CRISIS

REFS: A) Reykjavik 217 B) Evans-Norton telecon C) Evans-Meyers telecon

11. (U) Summary: Prime Minister Geir H. Haarde addressed the nation late on October 6 with a sober message: the banking system in Iceland was broken because of the global liquidity crisis and the government was taking emergency action to save Icelanders' domestic savings. Immediately following his address, Haarde presented emergency legislation at Althingi (Parliament) which passed just before midnight. This legislation gave the Icelandic government power to create financial institutions and to intervene in existing ones. It removed the cap on insurance for domestic savings deposits in Icelandic krona and allowed the State Housing Fund to take over all mortgages.

12. (SBU) Summary continued: Icelanders woke up on October 7 to learn that Landsbanki, the biggest bank in Iceland, was being taken over by the Financial Supervisory Authority. They heard assurances that domestic savings were safe and domestic banking operations would continue. The Icelandic krona started trading at 127 to USD, over a 100 percent devaluation from January 1 and bad news for Icelanders who have foreign currency mortgages and car loans, but the Central Bank quickly pegged the krona at 96 to USD. A five member team from the International Monetary Fund arrived on Sunday at the invitation of the Prime Minister and is providing advice. The media reported that Russia is offering a 4 billion euro loan to the Central Bank but there has been no official announcement that the loan is accepted or how that will affect the current situation. We continue to monitor this fluid situation. End Summary.

13. (U) Following a weekend of continuous meetings with stakeholders, Prime Minister Geir H. Haarde addressed the nation at 4:00 pm on October 6 with serious news. He explained the current financial crisis was a global problem and Icelandic banks' past success meant that their liabilities are too large for the government (we understand about eight times GDP) to offer them a secure lifeline. Haarde hinted that the Icelandic financial system might be at the edge of breakdown and he would not risk Iceland's future for a bailout. He said the banking system would have to be redesigned for Iceland before it could conduct international business again and announced that the buying and selling of stocks in the financial institutions would continue to remain frozen. He said that all of the nation's savings deposit would be secured. He called for unity among people and that the nation should stick to the values they hold dearest. Haarde reminded that Iceland was blessed with natural resources and that would ensure a bright future even if the financial system will need to be rebuilt. He closed his address with "God Bless Iceland," a phrase rarely used by politicians here.

14. (U) Soon after the address, the PM introduced emergency legislation at the Althingi (Parliament) which shortly passed before midnight with a few minor changes suggested by the opposition. The newly passed emergency legislation gives the Icelandic government power to create financial institutions and to intervene in existing ones. Under the law, the government has wide-ranging authority to take over banks, seize control of management and direct asset sales.

The bill will also allow the government to take over housing loans held by the banks and put them in a government housing fund, an effort to help thousands of Icelanders who faced the loss of their homes amid rising payments due to inflation and the krona's devaluation (Note: All mortgages are inflation indexed and many were denominated in foreign currency. End Note.) A critical part of the new law is that Government of Iceland ensures that deposits in domestic commercial and savings banks and their branches in Iceland will be fully covered. "Deposit" refers to all deposits by general customers and companies which are covered by the Deposit Division of the Depositors and Investors Guarantee Fund.

15. (U) On October 7, the Icelandic Financial Supervisory Authority (FME) announced that it had proceeded to take control of Landsbanki, the largest bank in Iceland. The FME announced in a statement that all domestic deposits are fully guaranteed and that all Landsbanki domestic branches, call centers, ATMs, and Internet operations will be open for business as usual. The statement continued that the action taken is a necessary first step in achieving the objectives of the Icelandic Government and Parliament to ensure the continued orderly operation of domestic banking and the safety of domestic deposits.

16. (U) At opening of business on October 7, the Icelandic krona was trading at 127 to USD, over a 100 percent devaluation from January 11. The media reported at 10 am local time that the krona is now pegged at 96 to USD. The Central Bank announced the fixing of the krona at a rate corresponding to 131 per euro, effective immediately and that further moves to boost the currency will be announced in coming days.

17. (SBU) A five member team from the International Monetary Fund arrived on Sunday at the invitation of the Prime Minister. Econoff talked with Rodolfo Luzio of the IMF team who confirmed that they are providing advice to the Government and that all options are on

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the table for IMF assistance. Luzio said that the IMF had been watching Iceland for some time and had visited earlier this summer. He noted that the situation was very fluid and he was unable to predict how long he would be in Iceland or what assistance would be provided. Luzio said that the plan for bank intervention was a done deal before they arrived on October 5.

18. (U) On October 7, the Russian Ambassador to Iceland, Victor Tatarintsev, informed David Oddsson, the Chairman of the Board of Governors of the Central Bank of Iceland, that Russia will provide Iceland with a 4 billion Euros or 5.4 billion USD loan. The Central Bank said in a statement that the loan would substantially strengthen Iceland's foreign reserves and support the Icelandic krona. The Central Bank said the loans were for three to four years on terms that would be 30-50 points above Libor rates. According to Reuters, Russian Deputy Finance Minister Dmitry Pankin said no decision had been taken on the loan.

VAN VOORST